



**SouthGobi Resources Ltd.**  
**Management's Discussion and Analysis of Financial Condition and  
Results of Operations**

**March 31, 2019**  
(Expressed in U.S. dollars)

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### FORWARD-LOOKING STATEMENTS

Except for statements of fact relating to SouthGobi Resources Ltd. and its subsidiaries (collectively, the "Company"), certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterized by words such as "plan", "expect", "project", "intend", "believe", "anticipate", "could", "should", "seek", "likely", "estimate" and other similar words or statements that certain events or conditions "may" or "will" occur. Forward-looking statements relate to management's future outlook and anticipated events or results and are based on the opinions and estimates of management at the time the statements are made. Forward-looking statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") include, but are not limited to, statements regarding:

- the Company continuing as a going concern and its ability to realize its assets and discharge its liabilities in the normal course of operations as they become due; adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and the impact thereof;
- the Company's expectations of sufficient liquidity and capital resources to meet its ongoing obligations and future contractual commitments, including the Company's ability to settle its trade payables, to secure additional funding and to meet its obligations under each of the China Investment Corporation ("CIC") convertible debenture (the "CIC Convertible Debenture"), the June 2017 Deferral Agreement (as such term is defined below), the Turquoise Hill Resources Ltd. ("Turquoise Hill") loan (the "TRQ Loan"), the Bank Loan and 2018 Bank Loan (as defined below), and the Settlement Deed (as defined below) with First Concept Industrial Group Limited ("First Concept"), as the same become due;
- the Company's anticipated financing needs, development plans and future production levels;
- the Company successfully obtaining shareholder approval of the 2019 Deferral Agreement (as defined below) at the Meeting (as defined below);
- the Company entering into discussions with CIC regarding a potential debt restructuring plan;
- the ability of the Company to successfully respond to any enforcement proceeding brought by First Concept in respect of the Arbitration Award and Settlement Deed;
- the results and impact of the Ontario class action (as described under Section 6 of this MD&A under the heading entitled "*Regulatory Issues and Contingencies – Class Action Lawsuit*");
- the impact of the Suspicious Transactions (as defined below) engaged in by Former Management and Employees (as defined below) and the results of the investigation conducted by the Special Committee (as defined below);
- the Company successfully implementing the Remedial Actions and Preventative Measures (as defined below) to address the issues which caused the Trading Suspension (as defined below);
- the ability of the Company to successfully satisfy the conditions necessary to resume trading of the Common Shares on the Hong Kong Stock Exchange ("HKEX") and the Toronto Stock Exchange ("TSX");
- the expected timing to complete the actions set out in the Trading Resumption Plan (as defined below) and to resume trading of the Common Shares on the HKEX and TSX;
- the estimates and assumptions included in the Company's impairment analysis and the possible impact of changes thereof;
- the agreement with Ejin Jinda and the payments thereunder (as described under Section 6 of this MD&A under the heading entitled "*Regulatory Issues and Contingencies – Toll Wash Plant Agreement with Ejin Jinda*");
- the ability of the Company to successfully negotiate a new agreement with the third party contractor relating to the operation of the wash plant at the Ovoot Tolgoi mine site;

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

- the ability of the Company to successfully recover the balance of its doubtful trade and notes receivables;
- the ability to enhance the operational efficiency and the output throughput of the of the washing facilities at Ovoot Tolgoi;
- the estimated annual wet washing capacity of the washing facilities at Ovoot Tolgoi;
- the ability to enhance the product value by conducting coal processing and coal washing;
- the impact of the Company's activities on the environment and actions taken for the purpose of mitigation of potential environmental impacts and planned focus on health, safety and environmental performance;
- the impact of the delays in the custom clearance process at the Ceke border on the Company's operations and the restrictions established by Chinese authorities on the import of F-grade coal into China;
- the future demand for coal in China;
- future trends in the Chinese coal industry;
- the Company's outlook and objectives for 2019 and beyond (as more particularly described under Section 11 of this MD&A under the heading entitled "*Outlook*"); and
- other statements that are not historical facts.

Forward-looking information is based on certain factors and assumptions described below and elsewhere in this MD&A, including, among other things: the current mine plan for the Ovoot Tolgoi mine; mining, production, construction and exploration activities at the Company's mineral properties; the costs relating to anticipated capital expenditures; the capacity and future toll rate of the paved highway; plans for the progress of mining license application processes; mining methods; the Company's anticipated business activities, planned expenditures and corporate strategies; management's business outlook, including the outlook for 2019 and beyond; the Company obtaining shareholder approval of the 2019 Deferral Agreement at the Meeting; the Company's ability to implement the Remedial Actions and Preventative Measures successfully; the Company's ability to satisfy the HKEX's resumption guidance conditions; the HKEX and the TSX accepting the Company's application for trading resumption; currency exchange rates; operating, labour and fuel costs; the ability of the Company to raise additional financing; the anticipated royalties payable under Mongolia's royalty regime; the future coal market conditions in China and the related impact on the Company's margins and liquidity; future coal prices, and the level of worldwide coal production. While the Company considers these assumptions to be reasonable based on the information currently available to it, they may prove to be incorrect. Forward-looking statements are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These risks and uncertainties include, among other things: the uncertain nature of mining activities, actual capital and operating costs exceeding management's estimates; variations in mineral resource and mineral reserve estimates; failure of plant, equipment or processes to operate as anticipated; the possible impacts of changes in mine life, useful life or depreciation rates on depreciation expenses; risks associated with, or changes to regulatory requirements (including environmental regulations) and the ability to obtain all necessary regulatory approvals; the potential expansion of the list of licenses published by the Government of Mongolia covering areas in which exploration and mining are purportedly prohibited on certain of the Company's mining licenses; the Government of Mongolia designating any one or more of the Company's mineral projects in Mongolia as a Mineral Deposit of Strategic Importance; continued delays in the custom clearance process at the Ceke border; the restrictions established by Chinese authorities on the import of F-grade coal into China; the Company being in default under the CIC Convertible Debenture, the June 2017 Deferral Agreement and the TRQ Loan, including the risk of CIC accelerating all amounts outstanding under the CIC Convertible Debenture and enforcing payment thereof, and the risk of Turquoise Hill demanding immediate payment of all amounts outstanding under the TRQ Loan, respectively; the risk of the Company failing to obtain shareholder approval of the 2019 Deferral Agreement at the Meeting; the possible impact of changes to the inputs to the valuation model used to value the embedded derivatives in the CIC Convertible Debenture;

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

the risk of the Company failing to successfully negotiate favorable repayment terms on the TRQ Reimbursable Amount (as described under Section 5 of this MD&A under the heading entitled "*Liquidity and Capital Management – Costs Reimbursable to Turquoise Hill*") ; the risk of the Company or its subsidiaries defaulting under its existing debt obligations, including the Bank Loan and 2018 Bank Loan, and the Settlement Deed; the impact of amendments to, or the application of, the laws of Mongolia, China and other countries in which the Company carries on business; modifications to existing practices so as to comply with any future permit conditions that may be imposed by regulators; delays in obtaining approvals and lease renewals; the risk of fluctuations in coal prices and changes in China and world economic conditions; the risk that First Concept initiates legal proceedings against SouthGobi Sands LLC ("SGS"), a subsidiary of the Company, pursuant to the Settlement Deed (as described under Section 5 of this MD&A under the heading entitled "*Liquidity and Capital Resources – Commercial Arbitration in Hong Kong*"); the outcome of the Class Action (as described under Section 6 of this MD&A under the heading entitled "*Regulatory Issues and Contingencies – Class Action Lawsuit*") and any damages payable by the Company as a result; the result of the internal investigation conducted by the Special Committee and the impact thereon on the Company; the risk that the Company fails to properly implement the Remedial Actions and Preventative Measures to address the issues which caused the Trading Suspension; the risk that the Remedial Actions and Preventative Measures fail to successfully address the issues which caused the Trading Suspension; the risk that the Company is unable to satisfy the conditions required to resume trading of the Common Shares on the TSX and the HKEX, including the risk that the Company fails to properly complete its Trading Resumption Plan; the risk that the Common Shares are delisted from trading on the TSX and the HKEX; the risk that the Company is unable to successfully negotiate a debt restructuring plan with CIC; the risk that the calculated sales price determined by the Company for the purposes determining of the amount of royalties payable to the Mongolian government is deemed as being "non-market" under Mongolian tax law; customer credit risk; cash flow and liquidity risks; the risk of continued delays in the custom clearance process at the Ceke border; risks relating to the Company's decision to suspend activities relating to the development of the Ceke Logistics Park project, including the risk that its investment partner may initiate legal action against the Company for failing to comply with the underlying agreements governing project development; risks relating to the ability of the Company to enhance the operational efficiency and the output throughput of the washing facilities at Ovoot Tolgoi; the risk that the Company is unable to successfully negotiate a new agreement with the third party contractor relating to the operation of the wash plant; risks relating to the Company's ability to raise additional financing and to continue as a going concern. Please see Section 10 of this MD&A under the heading entitled "*Risk Factors*" for a discussion of these and other risks and uncertainties relating to the Company and its operations. This list is not exhaustive of the factors that may affect any of the Company's forward-looking statements.

Due to assumptions, risks and uncertainties, including the assumptions, risks and uncertainties identified above and elsewhere in this MD&A, actual events may differ materially from current expectations. The Company uses forward-looking statements because it believes such statements provide useful information with respect to the currently expected future operations and financial performance of the Company, and cautions readers that the information may not be appropriate for other purposes. Except as required by law, the Company undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change. The reader is cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this MD&A; they should not rely upon this information as of any other date.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### TABLE OF CONTENTS

	<b>Page</b>
1. Overview.....	7
Significant Events and Highlights.....	7
2. Overview of Operational Data and Financial Results.....	16
3. Non-IFRS Financial Measures.....	21
4. Properties.....	22
Operating Mines.....	22
Mining Operations.....	23
5. Liquidity and Capital Resources.....	24
6. Regulatory Issues and Contingencies.....	33
7. Outstanding Share Data.....	35
8. Disclosure Controls and Procedures and Internal Controls Over Financial Reporting.....	36
9. Critical Accounting Estimates and Judgments.....	37
10. Risk Factors.....	38
11. Outlook.....	38

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### INTRODUCTION

This MD&A is dated as of May 14, 2019 should be read in conjunction with the condensed consolidated interim financial statements of the Company and the notes thereto for the three months ended March 31, 2019. The Company's condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34 - "Interim Financial Reporting" using accounting policies in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The condensed consolidated interim financial statements are presented in the U.S. Dollar, which is the functional currency of the Company and its controlled subsidiaries, except as subsequently mentioned.

The functional currency of the Company's Chinese subsidiaries (SouthGobi Trading (Beijing) Co., Ltd., Inner Mongolia SouthGobi Energy Co., Ltd., and Inner Mongolia SouthGobi Enterprise Co., Ltd.) was Renminbi ("RMB") and the functional currency of the Company's Mongolian operations (SGS, Mazaalai Resources LLC, Mazaatt Holdings LLC and Dayarbulag LLC, RDCC LLC), was the Mongolian Tugrik ("MNT").

All figures in this MD&A are presented in U.S. dollars unless otherwise stated.

Disclosure of a scientific or technical nature in this MD&A in respect of the Company's material mineral projects was prepared by or under the supervision of the individuals set out in the table below, each of whom is a "Qualified Person" as that term is defined in National Instrument 43-101 – *Standards of Disclosure for Mineral Projects* ("NI 43-101") of the Canadian Securities Administrators:

Property	Qualified Persons	Field of Expertise	Relationship to Company
Ovoot Tolgoi	Dr. Weiliang Wang	Resources	Independent Consultant
Ovoot Tolgoi	Vincent Li	Reserves	Independent Consultant
Soumber	Merryl Peterson	Resources	Independent Consultant
Zag Suuj	Merryl Peterson	Resources	Independent Consultant

Disclosure of a scientific or technical nature relating to the Ovoot Tolgoi Mine contained in this MD&A is derived from a technical report (the "Ovoot Tolgoi Technical Report") prepared in accordance with NI 43-101 on the Ovoot Tolgoi Mine dated May 15, 2017, prepared by Dr. Weiliang Wang, Mr. Vincent Li and Mr. Larry Li of Dragon Mining Consulting Limited ("DMCL"). A copy of the Ovoot Tolgoi Technical Report is available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

Disclosure of a scientific or technical nature relating to the Soumber Deposit contained in this MD&A is derived from a technical report (the "Soumber Technical Report") prepared in accordance with NI 43-101 on the Soumber Deposit dated March 25, 2013, prepared by Minarco-MineConsult and scientific and technical disclosure relating to the Zag Suuj Deposit is derived from a technical report (the "Zag Suuj Technical Report") prepared in accordance with NI 43-101 on the Zag Suuj Deposit dated March 25, 2013, prepared by Minarco-MineConsult. Copies of the Soumber Technical Report and the Zag Suuj Technical Report are available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com). These reports are effective as at these dates. Minarco-MineConsult has not reviewed or updated these reports since the date of publishing.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### 1. OVERVIEW

The Company is an integrated coal mining, development and exploration company with 472 employees as at March 31, 2019. The Company's common shares ("Common Shares") are listed for trading on the TSX under the symbol SGQ and on the HKEX under the stock code symbol 1878.

The Company owns a 100% interest in the Ovoot Tolgoi open pit coal mine (the "Ovoot Tolgoi Mine") and the following significant development projects, the Soumber Deposit and the Zag Suuj Deposit. These projects are located in the Umnugobi Aimag (South Gobi Province) of Mongolia, all of which are located within 150 kilometers ("km") of each other and in close proximity to the Mongolia-China border.

The Ovoot Tolgoi Mine, strategically located approximately 40km from the Shivee Khuren-Ceke crossing at the Mongolia-China border ("Shivee Khuren Border Crossing"), is the Company's flagship asset. The Company commenced mining at the Ovoot Tolgoi Mine in 2008. The Company sells a portion of its coal at the mine-gate to Chinese customers, while the remaining coal inventory is transported to China and sold via its Chinese subsidiaries at the stockyards in Ceke (Ceke, on the Chinese side of the Shivee Khuren Border Crossing, which is a major Chinese coal distribution terminal with rail connections to key coal markets in China) or certain designated locations in China as requested by customers.

Saleable products from the Ovoot Tolgoi Mine primarily consist of SouthGobi standard ("Standard") and SouthGobi premium ("Premium") semi-soft coking coal products. Some higher ash content product is washed and sold as semi-soft coking coal product while some of the unwashed product is sold as a thermal coal product, as and when the market allows.

#### **Significant Events and Highlights**

The Company's significant events and highlights for the three months ended March 31, 2019 and the subsequent period to May 14, 2019 are as follows:

- **Operating Results** – The Company increased sales volume to 1.1 million tonnes for the first quarter of 2019 from 0.6 million tonnes for the first quarter of 2018. Despite an improvement of the product mix, the average realized selling price decreased from \$43.0 per tonne in the first quarter of 2018 to \$34.9 per tonne in the first quarter of 2019 as a result of a higher portion of sales made at the mine gate instead of transporting the coal to the Company's Inner Mongolia subsidiary and selling to third party customers within China.
- **Financial Results** – The Company recorded a gross profit of \$13.4 million in the first quarter of 2019 compared to \$6.7 million in the first quarter of 2018, while a \$9.9 million profit from operations was recorded in the first quarter of 2019 compared to a \$3.5 million profit from operations in the first quarter of 2018 (restated). The improvement of overall financial results were principally attributable to lower unit cost of sales of products sold during the quarter.
- **CIC Convertible Debenture** – On April 23, 2019, the Company executed the 2019 Deferral Agreement with CIC in relation to a deferral and revised repayment schedule in respect of (i) \$41.8 million of outstanding cash and payment in kind interest ("PIK Interest") and associated costs due and payable to CIC on November 19, 2018 (the "Outstanding Interest Payable") under the CIC Convertible Debenture and the June 2017 Deferral Agreement; and (ii) the cash and PIK Interest payments payable to CIC under the CIC Convertible Debenture from April 23, 2019 to and including May 19, 2020 (the "Deferral"). Pursuant to Section 501(c) of the TSX Company Manual, the Company will be seeking approval of the 2019 Deferral Agreement from disinterested shareholders at the Company's upcoming annual and special meeting of shareholders (the "Meeting") to be held on May 30, 2019. The effectiveness of the 2019 Deferral Agreement and the respective covenants, agreements and

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

obligations of each party under the 2019 Deferral Agreement are subject to the Company obtaining the requisite approval from shareholders at the Meeting.

The key repayment terms of the 2019 Deferral Agreement are: (i) the Company agreed to pay \$14.3 million by eight instalments during November 2019 to June 2020; (ii) the Company agreed to pay the PIK Interest covered by the Deferral by way of cash payments, rather than the issuance of Common Shares; and (iii) the Company agreed to pay \$62.6 million on June 20, 2020. The Company agreed to pay a deferral fee at a rate of 6.4% per annum in consideration of the deferred amounts.

As a condition to agreeing to the Deferral, CIC required that the mutual co-operation agreement (the "Cooperation Agreement") dated November 19, 2009 between SGS and Fullbloom Investment Corporation ("Fullbloom"), an affiliate of CIC, be amended and restated (the "Amended and Restated Cooperation Agreement") to clarify the manner in which the service fee payable to Fullbloom under the Cooperation Agreement is calculated, with effect as of January 1, 2017. Specifically, the service fee under the Amended and Restated Cooperation Agreement will be determined based on the net revenues realized by the Company and all of its subsidiaries derived from sales into China (rather than the net revenues realized by the Company and its Mongolian subsidiaries as currently contemplated under the Cooperation Agreement). As consideration for deferring payment of the additional service fees payable to Fullbloom as a result of the Amended and Restated Cooperation Agreement (the "Deferred Compensation"), the Company agreed to pay to Fullbloom a deferral fee at the rate of 2.5% on the outstanding amount of the Deferred Compensation. Pursuant to the Amended and Restated Cooperation Agreement, the Company agreed to pay Fullbloom the Deferred Compensation and related accrued deferral fee of \$4.2 million in six instalments between June 2019 and November 2019. The effectiveness of the Amended and Restated Cooperation Agreement is subject to the Company obtaining the requisite approval of the 2019 Deferral Agreement from shareholders at the Meeting.

The Company also announced that it intends to discuss a potential debt restructuring plan with respect to amounts owing to Land Breeze II S.a.r.l., a wholly-owned subsidiary of CIC, which is mutually beneficial to the Company and CIC within the next 6 months, and to form a special committee comprised of independent directors to ensure that the interests of its minority shareholders are fairly considered in the negotiation and review of any such restructuring; however, there can be no assurance that a favorable outcome will be reached.

As of the date of this MD&A, the Company has neither: (i) paid the Outstanding Interest Payable within the cure period provided for under the CIC Convertible Debenture; nor (ii) obtained shareholders approval of the 2019 Deferral Agreement. Consequently, the Company is in default under the CIC Convertible Debenture and the June 2017 Deferral Agreement. Furthermore, the Common Shares have now been suspended from trading on the HKEX and TSX for a period of more than five trading days since December 17, 2018 (the "Trading Suspension"), which represents another event of default under the CIC Convertible Debenture. Pursuant to the terms of the CIC Convertible Debenture and the June 2017 Deferral Agreement, CIC may, at its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement immediately due and payable, and take steps to enforce payment thereof, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

Because a deferral of the Outstanding Interest Payable was not in effect as at March 31, 2019, International Accounting Standard ("IAS") 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at March 31, 2019, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the CIC Convertible Debenture.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

- **Notice of Arbitration** – As of the date hereof, the Company has not paid the November 2018 and January 2019 monthly payments due under the Settlement Deed. On March 5, 2019, SGS received a notice from First Concept claiming that the Company is in default under the Settlement Deed and demanding payment of the full amount of the outstanding monthly payments due under the Settlement Deed, otherwise First Concept intends to commence legal action against SGS pursuant to the Settlement Deed. The Company is consulting with its independent litigation counsel regarding this matter; however, as a default is only triggered under the Settlement Deed where there has been a failure to pay two or more consecutive monthly instalment payments, the Company is of the view that SGS is not in default under the Settlement Deed. In the event that First Concept commences legal action against SGS regarding this matter, the Company intends to take appropriate steps to respond to such legal proceedings in the best interests of the Company through independent litigation counsel which has been retained by the Company for this purpose.

As at March 31, 2019, the outstanding amount payable to First Concept amounted to \$10.6 million (December 31, 2018: \$12.5 million).

- **Key Findings of Formal Investigation** – On December 17, 2018, the Company announced that it had learned of certain information relating to past conduct engaged in by former senior executive officers and employees of the Company (“Former Management and Employees”) which raised suspicions of serious fraud, misappropriation of Company assets and other criminal acts by the Former Management and Employees relating to prior transactions (“Suspicious Transactions”) between 2016 and the first half of 2018 involving the Company, Inner Mongolia SouthGobi Energy Co. Ltd. (“IMSGE”), a subsidiary of the Company, and certain coal trading and transportation companies, some of which are allegedly related to or controlled by the Former Management and Employees or their related persons. The Company filed a report with local police authorities in China in respect of certain of the Suspicious Transactions and, on December 17, 2018, the Board expanded the mandate of its special committee of independent non-executive directors (the “Special Committee”), which was previously established to initiate a formal internal investigation into certain legal charges against Mr. Aminbuhe (the Company’s former Chairman and Chief Executive Officer), to include a formal investigation (the “Formal Investigation”) of the Suspicious Transactions, the implicated Former Management and Employees, and their impact, if any, on the business and affairs of the Company. The Special Committee engaged Blake, Cassels & Graydon LLP as independent Canadian legal counsel, Zhong Lun Law Firm, as independent Chinese legal counsel, and Ernst & Young (China) Advisory Limited (the “Forensic Accountant”), as forensic accountants, to assist in the formal investigation.

On March 30, 2019, the Company announced that the Special Committee concluded the Formal Investigation and delivered a final report summarizing its key findings to the Board, which was adopted and approved at a meeting held on March 30, 2019.

The Formal Investigation concentrated on the following areas of focus (the “Areas of Focus”): (i) the arrangements of the Suspicious Transactions; (ii) the relationships between the Former Management and Employees and certain coal trading and transportation companies; (iii) any unidentified questionable transactions relating to the Former Management and Employees; and (iv) the potential impact of (i), (ii) and (iii) on the financial statements of the Company and its subsidiaries. During the course of the Formal Investigation, certain incomplete accounting/operational records of one of the Companies Under Investigation (as defined below) (“Company A”) were identified in Company’s employee computers. As a result, the Special Committee expanded the scope of the Area of Focus of the Formal Investigation to include: (i) a fund flow analysis of Company A; and (ii) a price analysis of the difference between Company A’s purchase prices from the Company and selling prices to downstream customers.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

Based on the Areas of Focus, the Special Committee examined and made findings in respect of a number of matters in connection with the Formal Investigation, including the following: (i) allegations that Mr. Aminbuhe, the Company's former Chairman and Chief Executive Officer, controlled certain companies the Company had business dealings (the "Companies Under Investigation"); (ii) uncollectable receivables from certain former customers and suppliers of the Company; (iii) the impact of the lawsuit filed by Jiayuguan Xiyuan Trading Co., Ltd., a former customer of IMSGE; and (iv) allegations of misconduct by the Former Management and Employees, including: (I) the grant of a RMB 5 million loan; (II) embezzlement of bank acceptance bills of RMB12 million; (III) endorsement of commercial acceptance bills of RMB71 million which were not supported by genuine commercial transactions; (IV) prepayments of RMB8.5 million for coal transportation services which were never received by the Company; and (V) prepayment of RMB16.4 million for coal transportation services which were never received by the Company.

Based on the information obtained from the Formal Investigation, the Special Committee concluded that four matters examined in connection with the Formal Investigation, having an aggregate value of approximately RMB41 million, involved improper conduct, fraud or misappropriation of assets (the "Fraudulent Transactions") and that one matter examined in connection with the Formal Investigation, having an aggregate value of approximately RMB71 million, involved an accounting reclassification error. From an accounting perspective, the Company does not anticipate that the Fraudulent Transactions will have any impact on its financial statements in the future as the Company has already recorded the appropriate provisions in the financial statements as at December 31, 2018, 2017 and 2016 and for the years then ended.

Based on the key findings of and information obtained from the Formal Investigation, the Company considered the resulting financial impact on its prior financial statements and restated certain items in the Company's financial statements for the years ended 2016 and 2017 (the "Prior Restatement"), as disclosed in the Company's audited annual consolidated financial statements and related management's discussion and analysis for the year ended December 31, 2018, copies of which are available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com). The Prior Restatement reflects the impact of the misappropriation of assets as well as the reclassification of certain balances of assets in the prior years. With respect to the three month period ended March 31, 2018, the net effect of the Prior Restatement was a decrease in the net comprehensive loss of \$0.4 million for the period. A summary of the requisite adjustments on the financial statements for the three month period ended March 31, 2018 is set forth in the table below:

<i>\$ in thousands</i>	<b>March 31, 2018</b>	<b>Loss decrease/ (increase)</b>	<b>March 31, 2018 (Restated)</b>
<b>Statement of comprehensive income extract</b>			
Other operating expenses	\$ (1,338)	\$ 581	\$ (757)
Finance income	258	(158)	100
<b>Net loss attributable to equity holders of the Company</b>	<b>\$ (3,460)</b>	<b>\$ 423</b>	<b>\$ (3,037)</b>
Other comprehensive income for the period	(3,328)	-	(3,328)
<b>Net comprehensive loss attributable to equity holders of the Company</b>	<b>\$ (6,788)</b>	<b>\$ 423</b>	<b>\$ (6,365)</b>

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

- **Trading Suspension on HKEX and TSX** - Subsequent to the announcement made by the Company on December 17, 2018 in relation to the Suspicious Transactions, the Common Shares have been suspended from trading on the HKEX and TSX since December 17, 2018.

On January 3, 2019, the HKEX provided the Company with certain resumption guidance, setting out the conditions which the Company must satisfy in order for trading of the Common Shares to resume on the HKEX. Pursuant to the resumption guidance, the Company is required to: (i) conduct a forensic investigation (the "Forensic Investigation") of the Suspicious Transactions involving the Former Management and Employees; (ii) disclose the findings of the Forensic Investigation and take appropriate remedial actions; and (iii) inform the market of all material information in order for the Company's shareholders and investors to appraise the Company's position. The HKEX has advised that it may modify or supplement the trading resumption guidance if the Company's situation changes. Pursuant to Rule 6.01A(1) of the HKEX's Listing Rules, the HKEX may cancel the listing of any securities that have been suspended from trading for a continuous period of 18 months. In the case of the Company, this 18-month period expires on June 16, 2020. The HKEX has also advised that if the Company fails to remedy the issues causing the Trading Suspension, fully comply with the HKEX's Listing Rules to the HKEX's satisfaction and resume trading of the Common Shares on the HKEX by June 16, 2020, the Listing Department of the HKEX will recommend that the HKEX's Listing Committee proceed with cancelling the Company's listing on the HKEX. Pursuant to Rules 6.01 and 6.10 of the HKEX's Listing Rules, the HKEX also has the right to impose a shorter specific remedial period, where appropriate. Pursuant to Rule 13.24A of the HKEX's Listing Rules, the Company is required to announce quarterly updates on developments relating to its Trading Resumption Plan (as defined below), including details of the actions taken, or to be taken, in order to remedy the issues causing the Trading Suspension and fully comply with the HKEX's Listing Rules, the progress of implementing the Trading Resumption Plan, details of any material change to the Trading Resumption Plan (including any delays thereof) and impact on the Company's business operations. The Company made its first quarterly update on March 15, 2019 and is required to announce additional updates every three months thereafter until resumption of trading on the HKEX or cancellation of the Company's listing on the HKEX (whichever is earlier).

The action items set out below (the "Trading Resumption Plan") were approved by the Board on March 30, 2019 in order to address the issues which caused the Trading Suspension, re-comply with the HKEX's Listing Rules and allow trading of the Common Shares to resume trading on the HKEX:

<b>Action Item</b>	<b>Date of Completion or Anticipated Completion</b>
The Company completes a forensic investigation into the Suspicious Transactions	The Forensic Accountant completed the forensic investigation and submitted its final investigation report to the Special Committee on March 26, 2019
The Special Committee concludes its formal investigation and, with the assistance of its professional advisors, completes its final report summarizing the key findings of the formal investigation and submits the same to the Board for consideration	The Special Committee delivered its final report to the Board on March 27, 2019
The Board meets to consider and, if deemed appropriate, approve the Special Committee's final report and the Trading Resumption Plan	The Board adopted and approved the Special Committee's final report and the key findings set out therein on March 30, 2019

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

The Company announces the material findings of the Special Committee in respect of the Suspicious Transactions that were investigated pursuant to the Formal Investigation and the Trading Resumption Plan	The Company announced the material findings of the Special Committee in respect of the Suspicious Transactions that were investigated pursuant to the Formal Investigation and the Trading Resumption Plan on March 30, 2019
The Company announces its financial results for the fiscal year ended December 31, 2018	The Company announced its 2018 fiscal year results on March 31, 2019
The Special Committee, with the assistance of its professional advisors, completes its assessment of the potential remedial actions and preventative measures available to the Company to address the issues which caused the Trading Suspension and prepares a report on its conclusions and recommendations for the Board. The Board considers the recommendations of the Special Committee and formalizes and approves a set of remedial actions and preventative measures	The Special Committee delivered its report setting out a set of recommended remedial actions and preventative measures to Board which was approved at a meeting held on April 28, 2019
The Company applies to the HKEX and the TSX for trading in the Common Shares to resume	The Company anticipates submitting an application to the HKEX and the TSX as soon as practicable after the recommended remedial actions and preventative measures have been implemented
The Company announces the remedial actions and preventative measures approved by the Board and the resumption of trading on the HKEX and the TSX	As soon as practicable after the HKEX and the TSX accepts the Company's application for trading resumption

The Trading Resumption Plan set forth above was approved by the Board based on the information and advice received as of March 30, 2019 and may be subject to change. In accordance with Rule 13.24A of the HKEX's Listing Rules, the Company will announce details of any material changes to the Trading Resumption Plan (including any delays thereof) as and when necessary.

- Remedial Actions and Preventative Measures** - On April 30, 2019, the Company announced that the Special Committee, with the assistance of Ernst & Young (China) Advisory Limited who served as forensic investigators in connection with the Formal Investigation, completed its assessment of the potential remedial actions and preventative measures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct. The Special Committee delivered its report setting out a set of recommended remedial actions and preventative measures (the "Remedial Actions and Preventative Measures") to the Board which was approved at a meeting of the Board held on April 28, 2019.

The Remedial Actions and Preventative Measures, which are summarized below, are intended to remediate the incidents identified in the Formal Investigation and address deficiencies in the implementation of the Company's existing practices and procedures. Issues identified of note for the purposes of such remediation include a lack of preventative measures to avoid conflicts of interests, the need for additional employee oversight and the need to enhance compliance with accounting

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

protocols and documentation retention.

The Company has already taken proactive steps to address some of the issues raised by the Formal Investigation, including but not limited to: ceasing business activities with companies allegedly controlled by the Company's former management, taking steps to defend claims by third parties attempting to link the Company to the aforementioned companies, and considering whether legal recourse, such as collection actions, can be taken in respect of certain matters.

The following is a summary of the Remedial Actions and Preventative Measures which were adopted and approved by the Board:

<b>Recommendation</b>	<b>Key Remedial and Preventative Objective(s)</b>
Enhance the Company's anti-fraud program, including establishing an internal audit function, conducting routine internal audits and developing a communication and training program for employees to effectively establish a culture of compliance within the Company, ensure existing policies (such as the whistleblower policy) work effectively and support the implementation of the Remedial Actions and Preventative Measures	Enhance employee oversight  Limit likelihood of conflicts of interest  Proper document retention and accounting protocols
Enhance "know your customer" procedures relating to the intake of new customers and/or granting of credit to customers	Limit likelihood of conflicts of interest  Proper document retention and accounting protocols
Enhance vendor due diligence and monitoring processes to screen third parties	Limit likelihood of conflicts of interest  Proper document retention and accounting protocols
Formalize a process to perform routine reconciliation of balances with customers and/or suppliers on a regular basis	Limit likelihood of conflicts of interest  Proper document retention and accounting protocols
Enhance the Company's Financial Delegation of Authority document relating to payment authorization and contract approval processes	Limit likelihood of conflicts of interest  Proper document retention and accounting protocols
Enhance controls around the use of commercial bills	Limit likelihood of conflicts of interest  Proper document retention and accounting protocols

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

Introduce segregation of employment duties	Limit likelihood of conflicts of interest
Enhance the standardization of human resources process and controls across different locations	Limit likelihood of conflicts of interest Proper document retention and accounting protocols
Ensure IT back up and document retention protocols, including employee return of Company-issued devices and subsequent archiving	Enhance employee oversight Proper document retention
Monitor the implementation of the Remedial Actions and Preventative Measures by establishing a special task force, comprised of managers of the Company's various business units and members of the internal audit function, which will be tasked with this responsibility, and will consider the engagement of third party experts to conduct a review of the results of the implementation and advise on further enhancements if necessary	Enhance employee oversight Limit the likelihood of conflicts of interest Proper document retention and accounting protocols

Management is committed to remediating the issues which caused the Trading Suspension in a timely manner and will begin implementing the Remedial Actions and Preventative Measures as soon as practicable. Once the Remedial Actions and Preventative Measures have been implemented, the Company will make a further announcement as to the results of the implementation of the Remedial Actions and Preventative Measures and the steps that the Company intends to take to apply for trading resumption on the HKEX and the TSX.

- Going Concern** – In 2016, the Company started its program to build a coal washing plant to upgrade the low quality fractions of its run-of-mine coals to higher value and higher margin products. The construction of the wash plant at the Ovoot Tolgoi mine was completed, and commissioning was started in October 2018. As of the date of this MD&A, the wash plant commissioning process remains in progress. The Company is currently in discussions with the wash plant operator concerning an agreement regarding the operation of the wash plant; however, there can be no assurance that a favorable outcome will be reached.

The current operation plan contemplates significantly higher volumes of production in order to achieve the Company's revenue and cash flow targets. Such plans will require a significant level of capital expenditure in waste rock stripping in 2019 and 2020. Such expenditures and other working capital requirements may require the Company to seek additional financing. There is no guarantee that the Company will be able to successfully execute the programs mentioned above and to secure other sources of financing. In addition, the current import restrictions on F-grade coal by Chinese authorities will further affect the short term cash inflow and may in turn undermine the execution of the operation plan. If the import restrictions on F-grade coal continue for an indefinite period, or if the Company fails to execute the aforementioned programs, or is unable to secure additional capital financing, or otherwise restructure or refinance its business in order to address its cash requirements through March 31, 2020, then the Company is unlikely to have sufficient cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments. This could result in

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

Unless the Company acquires additional sources of financing and/or funding in the short term, the ability of the Company to continue as a going concern is threatened. If the Company is unable to continue as a going concern, it may be forced to seek relief under applicable bankruptcy and insolvency legislation. See Section 5 of this MD&A under the heading entitled "Liquidity and Capital Resources" and Section 10 of this MD&A under the heading entitled "Risk Factors" for details. As at May 14, 2019, the Company had \$3.6 million of cash.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

## 2. OVERVIEW OF OPERATIONAL DATA AND FINANCIAL RESULTS

### Summary of Annual Operational Data

	Three months ended	
	March 31,	
	2019	2018
<b>Sales Volumes, Prices and Costs</b>		
Premium semi-soft coking coal		
Coal sales ( <i>millions of tonnes</i> )	0.11	0.03
Average realized selling price ( <i>per tonne</i> )	\$ 47.34	\$ 67.94
Standard semi-soft coking coal/ premium thermal coal		
Coal sales ( <i>millions of tonnes</i> )	0.85	0.41
Average realized selling price ( <i>per tonne</i> )	\$ 33.34	\$ 46.34
Standard thermal coal		
Coal sales ( <i>millions of tonnes</i> )	0.09	0.12
Average realized selling price ( <i>per tonne</i> )	\$ 34.88	\$ 25.40
Washed coal		
Coal sales ( <i>millions of tonnes</i> )	0.01	-
Average realized selling price ( <i>per tonne</i> )	\$ 45.07	\$ -
Total		
Coal sales ( <i>millions of tonnes</i> )	1.06	0.56
Average realized selling price ( <i>per tonne</i> )	\$ 34.91	\$ 43.02
Raw coal production ( <i>millions of tonnes</i> )	1.03	0.38
Cost of sales of product sold ( <i>per tonne</i> )	\$ 22.08	\$ 31.64
Direct cash costs of product sold ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 10.82	\$ 16.86
Mine administration cash costs of product sold ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 1.41	\$ 1.23
Total cash costs of product sold ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 12.23	\$ 18.09
<b>Other Operational Data</b>		
Production waste material moved ( <i>millions of bank cubic meters</i> )	4.91	2.88
Strip ratio ( <i>bank cubic meters of waste material per tonne of coal produced</i> )	4.76	7.55
Lost time injury frequency rate <sup>(ii)</sup>	0.00	0.13

(i) A non-IFRS financial measure, see section 3. Cash costs of product sold exclude idled mine asset cash costs.

(ii) Per 200,000 man hours and calculated based on a rolling 12-month average.

### Overview of Operational Data

The Company ended the first quarter of 2019 without a lost time injury. As at March 31, 2019, the Company has a lost time injury frequency rate of nil per 200,000 man hours based on a rolling 12 month average.

Despite an improvement of the product mix, the average realized selling price decreased from \$43.0 per tonne in the first quarter of 2018 to \$34.9 per tonne in the first quarter of 2019 as a result of a higher portion of sales made at the mine gate instead of transporting the coal to the Company's Inner Mongolia subsidiary and selling to third party customers within China.

The product mix for the first quarter of 2019 consisted of approximately 10% of premium semi-soft coking coal, 80% of standard semi-soft coking coal, 9% of thermal coal and 1% of washed coal compared to

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

approximately 6% of premium semi-soft coking coal, 72% of standard semi-soft coking coal and 22% of thermal coal in the first quarter of 2018.

The Company sold 1.1 million tonnes for the first quarter of 2019 as compared to 0.6 million tonnes for the first quarter of 2018.

The Company's production in the first quarter of 2019 was higher than the first quarter of 2018 as a result of pacing production to meet the expected sales as well as a lower strip ratio achieved for the quarter, yielding 1.0 million tonnes for the first quarter of 2019 as compared to 0.4 million tonnes for the first quarter of 2018.

The Company's unit cost of sales of product sold decreased to \$22.1 per tonne in the first quarter of 2019 from \$31.6 per tonne in the first quarter of 2018. The decrease was mainly driven by increased sales and the related economies of scale.

### Summary of Financial Results

	Three months ended March 31,	
	2019	2018 <sup>(iii)</sup> (Restated)
<i>\$ in thousands, except per share information</i>		
Revenue <sup>(i)</sup>	\$ 36,811	\$ 24,435
Cost of sales <sup>(i)</sup>	(23,405)	(17,719)
Gross profit excluding idled mine asset costs <sup>(ii)</sup>	14,357	10,250
Gross profit	13,406	6,716
Other operating expenses	(414)	(757)
Administration expenses	(3,109)	(2,377)
Evaluation and exploration expenses	(25)	(124)
Profit from operations	9,858	3,458
Finance costs	(6,739)	(6,006)
Finance income	17	100
Share of earnings of a joint venture	452	340
Income tax expense	(1,439)	(929)
Net profit/(loss)	2,149	(3,037)
Basic and diluted earnings/(loss) per share	\$ 0.01	\$ (0.01)

(i) Revenue and cost of sales related to the Company's Ovoot Tolgoi Mine within the Mongolian Coal Division operating segment. Refer to note 3 of the condensed consolidated financial statements for further analysis regarding the Company's reportable operating segments. Royalties have been reclassified from revenue to cost of sales.

(ii) A non-IFRS financial measure, idled mine asset costs represents the depreciation expense relates to the Company's idled plant and equipment.

(iii) The financial results for the three months ended March 31, 2018 were restated. Refer to Section 1 of this MD&A under the heading entitled "Key Findings of Formal Investigation" for details.

### Overview of Financial Results

The Company recorded a \$9.9 million profit from operations in the first quarter of 2019 compared to a \$3.5 million profit from operations in the first quarter of 2018 (restated). The improvement of overall financial results were principally attributable to lower unit cost of sales of products sold during the quarter.

Revenue was \$36.8 million in the first quarter of 2019 compared to \$24.4 million in the first quarter of 2018. The Company's effective royalty rate for the first quarter of 2019, based on the Company's average realized selling price of \$34.9 per tonne, was 6.1% or \$2.1 per tonne, compared to 5.0% or \$2.1 per tonne in the first quarter of 2018 (based on the average realized selling price of \$43.0 per tonne in the first quarter of 2018).

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

### Royalty regime in Mongolia

The royalty regime in Mongolia is evolving and has been subject to change since 2012.

On February 1, 2016, the Government of Mongolia issued a resolution in connection with the royalty regime. From February 1, 2016 onwards, royalties are to be calculated based on the actual contract price including transportation costs to the Mongolia border. If such transportation costs have not been included in the contract, the relevant transportation costs, customs documentation fees, insurance and loading costs should be estimated for the calculation of royalties. In the event that the calculated sales price as described above differs from the contract sales price of other entities in Mongolia (same quality of coal and same border crossing) by more than 10%, the calculated sales price will be deemed to be "non-market" under Mongolian tax law and the royalty will then be calculated based on a reference price as determined by the Government of Mongolia. See the section entitled "*Risk Factors - Company's Projects in Mongolia*" in the Company's most recently filed Annual Information Form for the year ended December 31, 2018, a copy of which is available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

Cost of sales was \$23.4 million in the first quarter of 2019 compared to \$17.7 million in the first quarter of 2018. The increase in cost of sales was mainly due to the increased sales during the quarter. Cost of sales consists of operating expenses and royalties, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a Non-IFRS financial measure, see Section 3 of this MD&A for further analysis) during the quarter.

<i>\$ in thousands</i>	Three months ended March 31,	
	2019	2018
Operating expenses	\$ 12,968	\$ 10,132
Share-based compensation expense	2	-
Depreciation and depletion	3,779	2,841
Impairment of coal stockpile inventories	3,466	-
Royalties	2,239	1,212
Cost of sales from mine operations	22,454	14,185
Cost of sales related to idled mine assets	951	3,534
<b>Cost of sales</b>	<b>\$ 23,405</b>	<b>\$ 17,719</b>

Operating expenses in cost of sales were \$13.0 million in the first quarter of 2019 compared to \$10.1 million in the first quarter of 2018. The overall increase in operating expenses was primarily due to the net effect of: (i) increased sales volume from 0.6 million tonnes in the first quarter of 2018 to 1.1 million tonnes in the first quarter of 2019; and (ii) lower unit costs achieved through improvement of operational efficiency.

Cost of sales related to idled mine assets in the first quarter of 2019 included \$1.0 million related to depreciation expenses for idled equipment (first quarter of 2018: \$3.5 million).

Cost of sales in the first quarter of 2019 included coal stockpile impairments of \$3.5 million to reduce the carrying value of the Company's coal stockpiles to their net realizable value. The coal stockpile impairments recorded primarily related to the Company's higher-ash content products.

Other operating expenses was \$0.4 million in the first quarter of 2019 (first quarter of 2018: \$0.8 million).

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

	Three months ended March 31,	
	2019	2018 (Restated)
<i>\$ in thousands</i>		
Provision for doubtful trade and other receivables	\$ (51)	\$ (522)
CIC management fee	(758)	(583)
Foreign exchange gain	529	779
Loss on disposal of property, plant and equipment	-	(67)
Provision for commercial arbitration	(134)	(224)
Penalty on late settlement of trade payables	-	(104)
Other	-	(36)
Other operating expenses	\$ (414)	\$ (757)

Administration expenses were \$3.1 million in the first quarter of 2019 as compared to \$2.4 million in the first quarter of 2018, as follows:

	Three months ended March 31,	
	2019	2018
<i>\$ in thousands</i>		
Corporate administration	\$ 421	\$ 668
Professional fees	1,447	515
Salaries and benefits	1,069	1,134
Share-based compensation expense	12	16
Depreciation	160	44
Administration expenses	\$ 3,109	\$ 2,377

The increase was mainly due to the increase in professional fee incurred in connection with the Formal Investigation.

The Company continued to minimize evaluation and exploration expenditures in the first quarter of 2019 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in the first quarter of 2019 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining licenses.

Finance costs were \$6.7 million and \$6.0 million in the first quarter of 2019 and 2018 respectively, which primarily consisted of interest expense on the \$250.0 million CIC Convertible Debenture.

Finance income was negligible for the first quarter of 2019 (first quarter of 2018: \$0.1 million), which was primarily related to bank interest income.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

### Summary of Quarterly Operational Data

Quarter Ended	2019	2018				2017		
	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun
<b>Sales Volumes, Prices and Costs</b>								
Premium semi-soft coking coal								
Coal sales (millions of tonnes)	0.11	0.24	0.25	0.07	0.03	0.37	0.12	0.18
Average realized selling price (per tonne)	\$ 47.34	\$ 47.37	\$ 48.15	\$ 59.98	\$ 67.94	\$ 50.47	\$ 46.55	\$ 45.67
Standard semi-soft coking coal/ premium thermal coal								
Coal sales (millions of tonnes)	0.85	0.40	0.26	0.19	0.41	0.60	0.41	0.79
Average realized selling price (per tonne)	\$ 33.34	\$ 32.60	\$ 34.40	\$ 33.80	\$ 46.34	\$ 37.49	\$ 28.32	\$ 26.69
Standard thermal coal								
Coal sales (millions of tonnes)	0.09	0.12	0.22	0.32	0.12	0.29	0.27	0.51
Average realized selling price (per tonne)	\$ 34.88	\$ 24.26	\$ 23.49	\$ 26.32	\$ 25.40	\$ 16.98	\$ 14.48	\$ 15.79
Washed coal								
Coal sales (millions of tonnes)	0.01	0.15	-	-	-	-	-	-
Average realized selling price (per tonne)	\$ 45.07	\$ 44.02	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total								
Coal sales (millions of tonnes)	1.06	0.91	0.73	0.58	0.56	1.26	0.80	1.48
Average realized selling price (per tonne)	\$ 34.91	\$ 37.32	\$ 35.77	\$ 32.81	\$ 43.02	\$ 36.54	\$ 26.41	\$ 25.24
Raw coal production (millions of tonnes)	1.03	1.87	1.11	0.98	0.38	0.51	2.47	1.89
Cost of sales of product sold (per tonne)	\$ 22.08	\$ 30.80	\$ 23.44	\$ 29.27	\$ 31.64	\$ 23.54	\$ 31.31	\$ 18.50
Direct cash costs of product sold (per tonne) <sup>(i)</sup>	\$ 10.82	\$ 8.73	\$ 7.41	\$ 10.12	\$ 16.86	\$ 9.91	\$ 10.98	\$ 7.84
Mine administration cash costs of product sold (per tonne) <sup>(i)</sup>	\$ 1.41	\$ 2.19	\$ 1.24	\$ 1.00	\$ 1.23	\$ 4.92	\$ 2.98	\$ 2.22
Total cash costs of product sold (per tonne) <sup>(i)</sup>	\$ 12.23	\$ 10.92	\$ 8.65	\$ 11.12	\$ 18.09	\$ 14.83	\$ 13.96	\$ 10.06
<b>Other Operational Data</b>								
Production waste material moved (millions of bank cubic meters)	4.91	5.54	4.56	5.18	2.88	4.36	6.77	6.36
Strip ratio (bank cubic meters of waste material per tonne of coal produced)	4.76	2.97	4.11	5.26	7.55	8.59	2.74	3.37
Lost time injury frequency rate <sup>(ii)</sup>	0.00	0.00	0.00	0.06	0.13	0.20	0.23	0.18

(i) A non-IFRS financial measure, see section 3. Cash costs of product sold exclude idled mine asset cash costs.

(ii) Per 200,000 man hours and calculated based on a rolling 12-month average.

### Summary of Quarterly Financial Results

The Company's annual financial statements are reported under IFRS issued by the IASB. The following table provides highlights, extracted from the Company's annual and interim financial statements, of quarterly results for the past eight quarters:

\$ in thousands, except per share information

Quarter Ended	2019	2018				2017		
	31-Mar	31-Dec	30-Sep (Restated)	30-Jun (Restated)	31-Mar (Restated)	31-Dec (Restated)	30-Sep (Restated)	30-Jun
<b>Financial Results</b>								
Revenue <sup>(i)</sup>	\$ 36,811	\$ 33,814	\$ 26,277	\$ 19,278	\$ 24,435	\$ 41,698	\$ 19,356	\$ 34,665
Cost of sales <sup>(i)</sup>	(23,405)	(28,027)	(17,110)	(16,979)	(17,719)	(29,665)	(25,049)	(27,385)
Gross profit/(loss) excluding idled mine asset costs	14,357	7,305	13,195	6,079	10,250	15,682	(2,094)	9,445
Gross profit/(loss) including idled mine asset costs	13,406	5,787	9,167	2,299	6,716	12,033	(5,693)	7,280
Other operating income/(expenses)	(414)	(2,921)	(3,417)	(16,512)	(757)	(4,971)	3,097	(4,045)
Administration expenses	(3,109)	(1,583)	(2,724)	(3,856)	(2,377)	(2,111)	(2,451)	(2,234)
Evaluation and exploration expenses	(25)	(36)	(40)	(156)	(124)	(52)	(48)	(144)
Impairment of property, plant and equipment	-	-	-	-	-	(11,171)	-	-
Profit/(loss) from operations	9,858	1,247	2,986	(18,225)	3,458	(6,272)	(5,095)	857
Finance costs	(6,739)	(10,899)	(5,758)	(5,958)	(6,006)	(5,960)	(5,674)	(5,494)
Finance income	17	13	106	8	100	143	142	50
Share of earnings of a joint venture	452	416	247	628	340	368	265	388
Income tax credit/(expense)	(1,439)	(1,023)	(267)	(1,609)	(929)	781	238	(2,714)
Net profit/(loss)	2,149	(10,246)	(2,686)	(25,156)	(3,037)	(10,940)	(10,124)	(6,913)
Basic and diluted earnings/(loss) per share	\$ 0.01	\$ (0.04)	\$ (0.01)	\$ (0.09)	\$ (0.01)	\$ (0.04)	\$ (0.04)	\$ (0.03)

(i) Revenue and cost of sales relate to the Company's Ovoot Tolgoi Mine within the Mongolian Coal Division operating segment. Refer to note 3 of the condensed consolidated financial statements for further analysis regarding the Company's reportable operating segments. Royalties have been reclassified from revenue to cost of sales.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### 3. NON-IFRS FINANCIAL MEASURES

The Company has included the non-IFRS financial measure “cash costs” in this MD&A to supplement its consolidated financial statements, which have been prepared in accordance with IFRS. The data presented is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

The Company believes that this measure, together with measures determined in accordance with IFRS, provides investors with useful information to evaluate the underlying performance of the Company. Non-IFRS financial measures do not have a standardized meaning prescribed under IFRS and therefore may not be comparable to similar measures employed by other companies. The non-IFRS financial measure is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

#### Cash Costs

The Company uses cash costs to describe its cash production and associated cash costs incurred in bringing the inventories to their present locations and conditions. Cash costs incorporate all production costs, which include direct and indirect costs of production, with the exception of idled mine asset costs and non-cash expenses which are excluded. Non-cash expenses include share-based compensation expense, impairments of coal stockpile inventories, depreciation and depletion of property, plant and equipment and mineral properties. The Company uses this performance measure to monitor its operating cash costs internally and believes this measure provides investors and analysts with useful information about the Company's underlying cash costs of operations. The Company believes that conventional measures of performance prepared in accordance with IFRS do not fully illustrate the ability of its mining operations to generate cash flows. The Company reports cash costs on a sales basis. This performance measure is commonly utilized in the mining industry.

The following table provides a reconciliation of the cash costs of product sold disclosed for the three months ended March 31, 2019 and March 31, 2018. The cash costs of product sold presented below may differ from cash costs of product produced depending on the timing of coal stockpile inventory turnover and impairments of coal stockpile inventories from prior periods.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

	Three months ended	
	March 31,	
	2019	2018
<i>\$ in thousands, except per tonne information</i>		
<b>Cash costs</b>		
Cost of sales determined in accordance with IFRS	\$ 23,405	\$ 17,719
Less royalties	(2,239)	(1,212)
Less non-cash expenses	(7,247)	(2,841)
Less non-cash idled mine asset costs	(951)	(3,534)
Total cash costs	12,968	10,132
Less idled mine asset cash costs	-	-
Total cash costs excluding idled mine asset cash costs	12,968	10,132
Coal sales ( <i>millions of tonnes</i> )	1.06	0.56
Total cash costs of product sold ( <i>per tonne</i> )	\$ 12.23	\$ 18.09

	Three months ended	
	March 31,	
	2019	2018
<i>\$ in thousands, except per tonne information</i>		
<b>Cash costs</b>		
Direct cash costs of product sold ( <i>per tonne</i> )	\$ 10.82	\$ 16.86
Mine administration cash costs of product sold ( <i>per tonne</i> )	1.41	1.23
Total cash costs of product sold ( <i>per tonne</i> )	\$ 12.23	\$ 18.09

The cash cost of product sold per tonne was \$12.2 for the first quarter of 2019, which has decreased from \$18.1 per tonne for the first quarter 2018. The reason for the decrease is primarily related to the lower strip ratio achieved in the first quarter of 2019 as a result of less production waste material being moved (strip ratio of 4.76 for the first quarter of 2019 as compared to 7.55 for the first quarter of 2018).

#### 4. PROPERTIES

The Company currently holds six mining licenses in Mongolia. The mining licenses pertain to the Ovoot Tolgoi Mine (MV-012726), the Soumber Deposit (MV-016869, MV-020436 and MV-020451) and the Zag Suuj deposit (MV-020676 and MV-020675).

##### Operating Mines

##### ***Ovoot Tolgoi Mine***

The Ovoot Tolgoi Mine is located in the southwest corner of the Umnugobi Aimag (South Gobi Province) of Mongolia. The deposit is within the administrative unit of Gurvantes Soum, 320km southwest of the provincial capital of Dalanzadgad and 950km southwest of the nation's capital of Ulaanbaatar. Mining operations at the Ovoot Tolgoi Mine have been carried out in two distinct areas, the Sunset pit to the west and the Sunrise pit to the east.

Saleable products from the Ovoot Tolgoi Mine primarily include the Standard and Premium semi-soft coking coal products. Some higher ash content product is being washed and sold as semi-soft coking coal products while some of the unwashed product is sold as a thermal coal product as and when the market allows. The Company intends to continue to develop markets for both its Premium and Standard semi-soft coking coal brands and to pursue long-term supply offtake with end users in China to complement its existing customer base and to gain best value for the Company's coal in the Chinese market. The Company is committed to further enhancing the quality of its coal products through wet washing and increasing its market penetration in China.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### **Resources**

A resource estimate for the Ovoot Tolgoi deposit is set out in the Ovoot Tolgoi Technical Report, which was prepared by DMCL on behalf of the Company. A copy of the Ovoot Tolgoi Technical Report was filed under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com) on May 15, 2017.

### **Reserves**

A reserve estimate for the Ovoot Tolgoi deposit is set out in the Ovoot Tolgoi Technical Report, which was prepared by DMCL on behalf of the Company. A copy of the Ovoot Tolgoi Technical Report was filed under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com) on May 15, 2017.

### **Mining Operations**

#### ***Mining Method***

The mining method employed at the Ovoot Tolgoi deposit could be described as open pit terrace mining utilizing large scale hydraulic excavators and shovels and trucks. Terrace mining is utilized where coal seams dip steeply and operating machinery on the coal seam roof and floor is not possible, due to the steep seam dips. Terraces, or benches, are excavated along fixed horizontal horizons and these benches intersect both coal and waste. Coal and waste are mined separately on each bench with dozers being used, as needed, to push coal or waste down to the excavator for loading onto trucks. This mining method allows large scale open pit mining to occur productively in steeply dipping coal seam environments. All waste is dumped ex-pit, as the steep dips preclude in-pit dumping.

The open pit limits extend across the Ovoot Tolgoi Mining License boundary into the adjacent lease held by MAK. As described previously, the Company and MAK have a cooperation agreement in place to allow mining across the boundary, which stipulates that SGS is responsible for removal of MAK waste but MAK is responsible for mining of MAK coal. Accordingly, the current reserve estimate does not include any coal within the MAK lease that must be extracted as part of the Company mining operation. Therefore, in the current mine plan, no revenue has been assumed for the MAK coal whereas costs have been assumed for stripping off the MAK waste.

#### ***Transportation Infrastructure***

On April 26, 2018, the Board of RDCC LLC increased the toll rate from MNT 1,200 per tonne of coal to MNT 1,500, effective from June 1, 2018.

The paved highway has a carrying capacity in excess of 20 million tonnes of coal per year.

For the three months ended March 31, 2019, RDCC LLC recognized toll fee revenue of \$1.8 million (2018: \$1.6 million).

#### ***Mining Equipment***

The key elements of the currently commissioned mining fleet includes: two Liebherr 996 (33m<sup>3</sup> & 36m<sup>3</sup>) hydraulic excavators, three Liebherr R9250 (15m<sup>3</sup>) hydraulic excavators and 19 MT4400AC (218 tonne capacity) haul trucks, together with various pieces of ancillary equipment.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### *Workforce*

As at March 31, 2019, SGS employed 423 employees in Mongolia. Of the 423 employees, 40 are employed in the Ulaanbaatar office, 2 in an outlying office and 381 at the Ovoot Tolgoi Mine site. Of the 423 employees based in Mongolia, 416 (98%) are Mongolian nationals and of those, 221 (53%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums.

## 5. LIQUIDITY AND CAPITAL RESOURCES

### Liquidity and Capital Management

The Company has in place a planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans.

### *Turquoise Hill Loan Facility*

On May 25, 2014, the Company announced it obtained the TRQ Loan in the form of a \$10 million revolving credit facility to meet its short term working capital requirements. The terms and conditions of this facility were filed on SEDAR ([www.sedar.com](http://www.sedar.com)) on June 2, 2014. The key commercial terms of the facility were: an original maturity date of August 30, 2014 (subsequently extended as described below); an interest rate of one-month US dollar London Interbank Offered Rate ("LIBOR") in effect plus 11% per annum; a commitment fee of 35% of the interest rate payable quarterly in arrears on undrawn principal amount of facility and a front end fee of \$0.1 million.

During 2014 to 2016, the due date of the TRQ Loan, was extended several times and the maximum amount of the facility was reduced to \$3.8 million.

On August 29, 2018, the Company and Turquoise Hill entered into a deferral agreement (the "August 2018 Deferral Agreement"), whereby Turquoise Hill agreed to a limited deferral of repayment of all remaining amounts and obligations owing under the TRQ Loan to February 28, 2019 in accordance with the schedule of repayments set out below:

- The Company agreed to effect monthly repayments on the last business day of each month in an amount of (i) \$0.1 million per month from August 2018 to September 2018; (ii) \$0.2 million per month from October 2018 to January 2019; and (iii) the remaining balance on February 28, 2019 (the payments in (i), (ii) and (iii), the "Repayments"); and
- Interest shall continue to accrue on all outstanding obligations at the 12-month US dollar LIBOR.

Unless otherwise agreed by Turquoise Hill, under certain circumstances, including the non-payment of interest amounts as the same become due, amounts outstanding under the TRQ Loan may be accelerated. Bankruptcy and insolvency events with respect to the Company or its material subsidiaries will result in an automatic acceleration of the indebtedness under the TRQ Loan. Subject to notice and cure periods, certain events of default under the TRQ Loan will result in acceleration of the indebtedness under such loan at the option of Turquoise Hill.

As of the date hereof, the Company has not paid a portion of the payment due in February 2019. Pursuant to the terms of the TRQ Loan and the August 2018 Deferral Agreement, the Company is, as of the date of this MD&A, in default of its obligations under the TRQ Loan and the August 2018 Deferral Agreement as a result of the Company failing to make the Repayments in its entirety on or before the dates set out above. Consequently, all of the outstanding obligations under the TRQ Loan and the August 2018 Deferral Agreement are immediately due and payable to Turquoise Hill as of the date hereof. As of the date of this

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

MD&A, the Company has received no indication from Turquoise Hill of any intention to demand payment of the amounts outstanding under the TRQ Loan and the August 2018 Deferral Agreement.

As at March 31, 2019, the outstanding principal and accrued interest under this facility amounted to \$nil and \$0.2 million, respectively (December 31, 2018: the outstanding principal and accrued interest under this facility amounted to \$nil and \$0.7 million, respectively).

### **Bank Loan**

On May 6, 2016, SGS obtained a bank loan (the "Bank Loan") in the principal amount of \$2.0 million from a Mongolian bank (the "Bank"). The principal terms of the Bank Loan include, among other things, an interest rate of 15.8% per annum, a maturity date of May 6, 2017 (subsequently extended as described below) and SGS being required to pledge certain of its mobile equipment in favour of the Bank as collateral for the Bank Loan.

On July 6, 2017, SGS and the Bank entered into a supplementary agreement with the key commercial terms of the Bank Loan modified as follows:

- Principal amount increased to \$3.0 million;
- \$2.3 million of the principal amount matured on May 6, 2018 while the remaining balance of the principal amount of \$0.7 million matured on January 4, 2019;
- Interest rate of 15.8% per annum applies to the \$2.3 million portion of the principal amount, while an interest rate of 15.0% per annum applies to the remaining \$0.7 million portion of the principal amount; in each case, interest is payable monthly; and
- Certain items of property, plant and equipment were pledged as security (subsequently released upon repayment of loan principal of \$2.3 million).

\$2.3 million and \$0.7 million of the loan principal was repaid to the Bank by the Company in May 2018 and January 2019, respectively, and the loan balance was fully settled.

On May 15, 2018, SGS and the Bank entered into another loan agreement with the key commercial terms as follows:

- Principal amount of the loan (the "2018 Bank Loan") of \$2.8 million;
- Maturity date set at 24 months from drawdown;
- Interest rate of 15% per annum and interest is payable monthly; and
- Certain items of property, plant and equipment were pledged as security for both the Bank Loan and the 2018 Bank Loan. As at March 31, 2019, the net book value of the pledged items of property, plant and equipment was \$1.6 million (December 31, 2018: \$2.6 million).

As at March 31, 2019, the outstanding principal balance of the Bank Loan, together with the 2018 Bank Loan, was \$2.8 million (December 31, 2018: \$3.5 million) and the accrued interest owed by the Company was negligible (December 31, 2018: negligible).

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### ***Costs reimbursable to Turquoise Hill***

Prior to the completion of a private placement with Novel Sunrise Investments Limited on April 23, 2015, Rio Tinto plc ("Rio Tinto") was the Company's ultimate parent company. In the past, Rio Tinto sought reimbursement from the Company for the salaries and benefits of certain Rio Tinto employees who were assigned by Rio Tinto to work for the Company, as well as certain legal and professional fees incurred by Rio Tinto in relation to the Company's prior internal investigation and Rio Tinto's participation in the tripartite committee. Subsequently Rio Tinto transferred and assigned to Turquoise Hill its right to seek reimbursement for these costs and fees from the Company.

As at March 31, 2019, the amount of reimbursable costs and fees claimed by Turquoise Hill (the "TRQ Reimbursable Amount") amounted to \$8.1 million (such amount is included in the aging profile of trade and other payables set out below). On October 12, 2016, the Company received a letter from Turquoise Hill, which proposed an arrangement for regular payments of the outstanding TRQ Reimbursable Amount although no agreement has been reached between the Company and Turquoise Hill as of the date of this MD&A. As of the date of this MD&A, the Company has received no indication from Turquoise Hill of any intention to demand payment of the TRQ Reimbursable Amount.

### ***Going concern considerations***

The Company's condensed consolidated interim financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least March 31, 2020 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. However, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transactions to provide it with additional liquidity.

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had a deficiency in assets of \$46.1 million as at March 31, 2019 compared to a deficiency in assets of \$48.1 million as at December 31, 2018 while the working capital deficiency (excess current liabilities over current assets) reached \$202.9 million as at March 31, 2019 compared to a working capital deficiency of \$203.1 million as at December 31, 2018. Included in the working capital deficiency at March 31, 2019 are significant obligations, which include the obligation to pay CIC under the June 2017 Deferral Agreement in which the Company was required to pay \$9.7 million of cash interest and associated costs on November 19, 2017. Pursuant to the terms of CIC Convertible Debenture, the Company was required to: (i) pay \$8.1 million, \$7.9 million and \$8.1 million of anniversary cash interest on November 19, 2017, May 19, 2018 and November 19, 2018, respectively; and (ii) issue to CIC \$4.0 million worth of PIK Interest shares on November 19, 2017 and \$4.0 million worth of PIK Interest shares on November 19, 2018, respectively.

The Company has executed the 2019 Deferral Agreement with CIC in relation to a deferral and revised repayment schedule in respect of the Outstanding Interest Payable and the cash and PIK Interest payments payable to CIC under the CIC Convertible Debenture from April 23, 2019 to and including May 19, 2020; however, the effectiveness of the 2019 Deferral Agreement and the respective covenants, agreements and obligations of each party under the 2019 Deferral Agreement are subject to the Company obtaining the requisite approval from shareholders at the Meeting. Until such time as the 2019 Deferral Agreement becomes effective, the principal amount outstanding and all accrued and unpaid interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement would immediately become due and payable in the event that CIC provides notice to the Company.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

The Company also has other current liabilities, which require settlement in the short-term, including: the \$10.6 million owing to First Concept under the Settlement Deed and \$26.1 million of unpaid taxes payable by SGS to the Mongolian government.

Further, the trade and other payables of the Company continue to accumulate due to liquidity constraints. The aging profile of the trade and other payables as at March 31, 2019 as compared to that as at December 31, 2018, is as follows:

	As at	
	March 31, 2019	December 31, 2018
<i>\$ in thousands</i>		
Less than 1 month	\$ 28,773	\$ 34,927
1 to 3 months	13,345	16,336
3 to 6 months	20,409	5,446
Over 6 months	34,283	42,867
<b>Total trade and other payables</b>	<b>\$ 96,810</b>	<b>\$ 99,576</b>

The Company may not be able to settle all trade and other payables on a timely basis, while continuing postponement in settling the trade payables may impact the mining operations of the Company and result in potential lawsuits and/or bankruptcy proceedings being filed against the Company. Except as disclosed elsewhere in this MD&A, no such lawsuits or proceedings are pending as at May 14, 2019.

In 2016, the Company started its program to build a coal washing plant to upgrade the low quality fractions of its run-of-mine coals to higher value and higher margin products. The construction of the wash plant at the Ovoot Tolgoi mine was completed, and commissioning was started in October 2018. As of the date hereof, the wash plant commissioning process remains in progress. The Company is currently in discussions with the wash plant operator concerning an agreement regarding the operation of the wash plant; however, there can be no assurance that a favorable outcome will be reached.

The current operation plan contemplates significantly higher volumes of production in order to achieve the Company's revenue and cash flow targets. Such plans will require a significant level of capital expenditure in waste rock stripping in 2019 and 2020. Such expenditures and other working capital requirements may require the Company to seek additional financing. There is no guarantee that the Company will be able to successfully execute the programs mentioned above and to secure other sources of financing. In addition, the current import restrictions on F-grade coal by Chinese authorities will further affect the short term cash inflow and may in turn undermine the execution of the operation plan. If the import restrictions on F-grade coal continue for an indefinite period, or if the Company fails to execute the aforementioned programs, or is unable to secure additional capital financing, or otherwise restructure or refinance its business in order to address its cash requirements through March 31, 2020, then the Company is unlikely to have sufficient cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments. This could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

Unless the Company acquires additional sources of financing and/or funding in the short term, the ability of the Company to continue as a going concern is threatened. If the Company is unable to continue as a going concern, it may be forced to seek relief under applicable bankruptcy and insolvency legislation.

As of the date of this MD&A, the Company is in default under the CIC Convertible Debenture, the June 2017 Deferral Agreement and the TRQ Loan. Pursuant to the terms of the CIC Convertible Debenture and the June 2017 Deferral Agreement, CIC may, at its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture and the June 2017

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

Deferral Agreement immediately due and payable, and take steps to enforce payment thereof. Pursuant to the terms of the TRQ Loan and the August 2018 Deferral Agreement, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. If the 2019 Deferral Agreement is not approved by shareholders at the Meeting and CIC takes steps to enforce payment under the CIC Convertible Debenture and the June 2017 Deferral Agreement, this would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value. As of the date of this MD&A, the Company has: (i) received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture and the June 2017 Deferral Agreement or to accelerate the payment of amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement; and (ii) has received no indication from Turquoise Hill of any intention to deliver a notice of default under the TRQ Loan.

Factors that impact the Company's liquidity are being closely monitored and include, but are not limited to, Chinese economic growth, market prices of coal, production levels, operating cash costs, capital costs, exchange rates of currencies of countries where the Company operates and exploration and discretionary expenditures.

As at March 31, 2019 and December 31, 2018, the Company was not subject to any externally imposed capital requirements.

As at May 14, 2019, the Company had \$3.6 million of cash.

### **CIC Convertible Debenture**

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of CIC for \$500 million in the form of a secured, convertible debenture bearing interest at 8.0% (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) with a maximum term of 30 years. The CIC Convertible Debenture is secured by a first ranking charge over the Company's assets and certain subsidiaries. The financing was used primarily to support the accelerated investment program in Mongolia and for working capital, repayment of debt, general and administrative expenses and other general corporate purposes.

On March 29, 2010, the Company exercised its right to call for the conversion of up to \$250.0 million of the CIC Convertible Debenture into approximately 21.5 million shares at a conversion price of \$11.64 (CAD\$11.88). As at March 31, 2019, CIC owned, through its indirect wholly owned subsidiary, approximately 23.8% of the issued and outstanding Common Shares of the Company.

On June 12, 2017, the Company executed the June 2017 Deferral Agreement with CIC for a revised repayment schedule on the May 2017 Interest Payable. The key repayment terms of the June 2017 Deferral Agreement are: (i) the Company was required to repay on average \$2.2 million of the cash interest and associated costs monthly during the period from May 2017 to October 2017; and (ii) the Company was required to repay \$9.7 million of cash interest and associated costs on November 19, 2017.

At any time before the payment under the terms of the June 2017 Deferral Agreement is fully repaid, the Company is required to consult with and obtain written consent from CIC prior to effecting a replacement or termination of either or both of its Chief Executive Officer and its Chief Financial Officer, otherwise this will constitute an event of default under the CIC Convertible Debenture, but CIC shall not withhold its consent if the Board proposes to replace either or both such officers with nominees selected by the Board, provided that the Board acted honestly and in good faith with a view to the best interests of the Company in the selection of the applicable replacements.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

In addition, pursuant to the terms of the CIC Convertible Debenture, the Company was required to pay \$8.1 million, \$7.9 million and \$8.1 million of anniversary cash interest to CIC on November 19, 2017, May 19, 2018 and November 19, 2018, respectively. Pursuant to the CIC Convertible Debenture, the Company was also obligated to issue to CIC \$4.0 million worth of PIK interest shares on November 19, 2017 and \$4.0 million worth of PIK Interest Shares on November 19, 2018.

On April 23, 2019, the Company executed the 2019 Deferral Agreement with CIC in relation to a deferral and revised repayment schedule in respect of (i) \$41.8 million of Outstanding Interest Payable under the CIC Convertible Debenture and the June 2017 Deferral Agreement; and (ii) the of cash and PIK Interest payments payable to Land Breeze II S.a.r.l. under the CIC Convertible Debenture from April 23, 2019 to and including May 19, 2020. Pursuant to Section 501(c) of the TSX Company Manual, the Company will be seeking approval of the 2019 Deferral Agreement from disinterested shareholders at the Meeting. The effectiveness of the 2019 Deferral Agreement and the respective covenants, agreements and obligations of each party under the 2019 Deferral Agreement are subject to the Company obtaining the requisite approval from shareholders at the Meeting.

The key repayment terms of the 2019 Deferral Agreement are: (i) the Company agreed to pay \$14.3 million, by eight instalments during November 2019 to June 2020; (ii) the Company agreed to pay the PIK Interest covered by the Deferral by way of cash payments, rather than the issuance of Common Shares; and (iii) the Company agreed to pay \$62.6 million on June 20, 2020. The Company agreed to pay a deferral fee at a rate of 6.4% per annum in consideration of the Deferral.

As a condition to agreeing to the Deferral, CIC required that the Cooperation Agreement between SGS and Fullbloom, an affiliate of CIC, be amended and restated to clarify the manner in which the service fee payable to Fullbloom under the Cooperation Agreement is calculated, with effect as of January 1, 2017. Specifically, the service fee under the Amended and Restated Cooperation Agreement will be determined based on the net revenues realized by the Company and all of its subsidiaries derived from sales into China (rather than the net revenues realized by the Company and its Mongolian subsidiaries as currently contemplated under the Cooperation Agreement). As consideration for deferring payment of the Deferred Compensation, the Company agreed to pay to Fullbloom a deferral fee at the rate of 2.5% on the outstanding amount of the Deferred Compensation. Pursuant to the Amended and Restated Cooperation Agreement, the Company agreed to pay Fullbloom the Deferred Compensation and related accrued deferral fee of \$4.2 million in six instalments between June 2019 and November 2019.

The effectiveness of the Amended and Restated Cooperation Agreement is subject to the Company obtaining the requisite approval of the 2019 Deferral Agreement from shareholders at the Meeting.

As of the date of this MD&A, the Company: (i) has neither paid the Outstanding Interest Payable within the cure period provided for under the CIC Convertible Debenture; and (ii) has not obtained the requisite approval at the Meeting to put the 2019 Deferral Agreement in effect. Consequently, the Company is in default under the CIC Convertible Debenture and the June 2017 Deferral Agreement. Furthermore, the Common Shares have now been suspended from trading on the HKEX and TSX for a period of more than five trading days since December 17, 2018 (the "Trading Suspension"), which represents another event of default under the CIC Convertible Debenture. Pursuant to the terms of the CIC Convertible Debenture and the June 2017 Deferral Agreement, CIC may, at its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement immediately due and payable, and take steps to enforce payment thereof, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

Under certain conditions, including the non-payment of interest amounts as the same become due or the Common Shares being suspended or halted from trading on any stock exchange for a period of longer than five trading days, amounts outstanding under the CIC Convertible Debenture may be accelerated. Bankruptcy and insolvency events with respect to the Company or its material subsidiaries will result in an automatic acceleration of the indebtedness under the CIC Convertible Debenture. Subject to notice and cure periods, certain events of default under the CIC Convertible Debenture will result in acceleration of the indebtedness under such debenture at the option of CIC. Such other events of default include, but are not limited to, non-payment, breach of warranty, non-performance of obligations under the CIC Convertible Debenture, default on other indebtedness and certain adverse judgments.

Because a deferral of the Outstanding Interest Payable was not in effect as of March 31, 2019, International Accounting Standard ("IAS") 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at March 31, 2019, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the CIC Convertible Debenture.

### ***Commercial Arbitration in Hong Kong***

On June 24, 2015, First Concept served a notice of arbitration (the "Notice") on SGS in respect of a coal supply agreement dated May 19, 2014 as amended on June 27, 2014 (the "Coal Supply Agreement") for a total consideration of \$11.5 million.

On January 10, 2018, the Company received a confidential partial award (final except as to costs) with respect to the commercial arbitration. Pursuant to the Arbitration Award, SGS was ordered to repay the sum of \$11.5 million (which SGS had received as a prepayment for the purchase of coal) to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. The Arbitration Award is final, except as to costs which were reserved for a future award.

On November 14, 2018, the Company executed the Settlement Deed with First Concept in respect of the Arbitration Award. The Settlement Deed provides for the full and final satisfaction of the Arbitration Award as well as the settlement of the issue of costs relating to the Arbitration and any other disputes arising out of the Coal Supply Agreement. Pursuant to the Settlement Deed, which provides for the full and final satisfaction of the Arbitration Award as well as the settlement of the issue of costs relating to the Arbitration and any other disputes arising out of the Coal Supply Agreement, SGS agreed to pay to First Concept the sum of \$13.9 million, together with simple interest thereon at the rate of 6% per annum from November 1, 2018 until full payment, in 12 monthly installments commencing in November 2018. Provided that SGS complies with the terms of the Settlement Deed, First Concept agreed to waive its costs in connection with the Arbitration and Arbitration Award and interest for the period from January 4, 2018 to October 31, 2018.

As of the date hereof, the Company has not paid the November 2018 and January 2019 monthly payments due under the Settlement Deed. On March 5, 2019, SGS received a notice from First Concept claiming that the Company is default under the Settlement Deed and demanding payment of the full amount of the outstanding monthly payments due under the Settlement Deed by no later than March 11, 2019, otherwise First Concept intends to commence legal action against SGS pursuant to the Settlement Deed. The Company is consulting with its independent litigation counsel regarding this matter; however, as a default is only triggered under the Settlement Deed where there has been a failure to pay two or more consecutive monthly instalment payments, the Company is of the view that SGS is not in default under the Settlement Deed. In the event that First Concept commences legal action against SGS regarding this matter, the Company intends to take appropriate steps to respond to such legal proceedings in the best interests of the Company through independent litigation counsel which has been retained by the Company for this purpose.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

As at March 31, 2019, the outstanding payables to First Concept amounted to \$10.6 million (December 31, 2018: \$12.5 million).

### Cash Flow Highlights

<i>\$ in thousands</i>	Three months ended March 31,	
	2019	2018
Cash generated from operating activities	\$ 14,582	\$ 12,422
Cash used in investing activities	(5,444)	(7,080)
Cash used in financing activities	(7,014)	(521)
Effect of foreign exchange rate changes on cash	(229)	(27)
Increase in cash for the period	1,895	4,794
Cash balance, beginning of period	6,959	6,471
Cash balance, end of period	\$ 8,854	\$ 11,265

### ***Cash generated from Operating Activities***

The Company generated \$14.6 million of cash from operating activities in the first quarter of 2019 compared to \$12.4 million in the first quarter of 2018. This is primarily due to the Company receiving an increased amount of coal sale deposits from customers.

### ***Cash used in Investing Activities***

The Company used \$5.4 million of cash during the first quarter of 2019 in investing activities compared to \$7.1 million during the first quarter of 2018. In the first quarter of 2019, expenditures on property, plant and equipment totaled \$6.0 million (2018: \$7.9 million) and \$0.5 million of dividend income was collected from RDCC LLC (2018: \$0.5 million).

### ***Cash used in Financing Activities***

Cash used in financing activities was \$7.0 million in the first quarter of 2019 (2018: \$0.5 million), which was principally attributable to the refund of certain customer deposits.

### **Contractual Obligations and Guarantees**

Day-to-day mining, expansionary and sustaining capital expenditures as well as administrative operations give rise to commitments for future minimum payments. As at March 31, 2019, the Company's operating and capital commitments were:

	Within 1 year	2-3 years	Over 3 years	Total
<b>As at March 31, 2019</b>				
Capital expenditure commitments	\$ 684	\$ -	\$ -	\$ 684
Operating expenditure commitments	15,957	179	1,605	17,741
<b>Commitments</b>	<b>\$ 16,641</b>	<b>\$ 179</b>	<b>\$ 1,605</b>	<b>\$ 18,425</b>

### **Ovoot Tolgoi Mine Impairment Analysis**

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at March 31, 2019. The impairment indicators were the uncertainty of future coal prices in China and the lower than budgeted production.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's Ovoot Tolgoi Mine cash generating unit was compared to its "fair value less costs of disposal" ("FVLCTD") using a discounted future cash flow valuation model. The Company's cash flow valuation model takes into consideration the latest available information to the Company, including but not limited to, sales prices, sales volumes, coal washing capacity, operating costs and life of mine coal production estimates as at March 31, 2019. The resulting FVLCTD was \$155.9 million as at March 31, 2019 while the cash generating unit carrying value of the Company's Ovoot Tolgoi Mine was \$139.5 million, resulting in a headroom of \$16.4 million.

Key estimates and assumptions incorporated in the valuation model included the following:

- Coal resources and reserves as estimated by an independent third party engineering firm;
- Sales price estimates from an independent market consulting firm;
- Forecasted sales volumes in line with production levels as reference to the mine plan;
- Life-of-mine coal production, strip ratio, capital costs and operating costs; and
- A post-tax discount rate of 11% based on an analysis of the market, country and asset specific factors.

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the long term price estimates, the calculated fair value of the cash generating unit increases/(decreases) by approximately \$16.9/(16.9) million;
- For each 1% increase/(decrease) in the post-tax discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately \$(9.8)/10.9 million;
- For each 1% increase/(decrease) in the cash mining cost estimates, the calculated fair value of the cash generating unit (decreases)/increases by approximately \$(13.3)/13.3 million; and
- For each 1% increase/(decrease) in Mongolian inflation rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately \$(76.8)/66.2 million.

The impairment analysis did not result in the identification of an impairment loss or an impairment reversal and no charge or reversal was required as at March 31, 2019. A decline of 1% in the long term price estimates, an increase of more than 2% in the post-tax discount rate, an increase of 1% in the cash mining cost estimates or an increase of 1% in Mongolian inflation rate may trigger an impairment charge on the cash generating unit. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

### **Financial Instruments**

The fair value of financial assets and financial liabilities at amortized cost is determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market transactions. The fair value of all the financial instruments of the Company approximates their carrying value because of the demand nature or short-term maturity of these instruments, except for the fair values of trade and other payables, interest bearing borrowings, and provision for commercial arbitration and convertible debenture below their respective carrying amounts given the current financial condition of the Company as described under Section 5 of this MD&A under the heading entitled "*Liquidity and Capital Management*".

The fair values of the embedded derivatives within the CIC Convertible Debenture are determined using a Monte Carlo simulation. The risks associated with the CIC Convertible Debenture relate to a potential breach of the Company's obligations under the terms of the CIC Convertible Debenture. The Company

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

mitigates these risks by ensuring its corporate activities comply with all of its contractual obligations under the CIC Convertible Debenture.

The fair value of the commercial notes receivables is determined based on the corporate bond yield of the bonds issued by the group companies of the notes issuing company.

<i>\$ in thousands</i>	<b>As at</b>	
	<b>March 31, 2019</b>	<b>December 31, 2018</b>
<b>Financial assets</b>		
Notes receivables	\$ 998	\$ 2,500
Cash	8,854	6,959
Restricted cash	894	872
Trade and other receivables	4,848	5,046
<b>Total financial assets</b>	<b>\$ 15,594</b>	<b>\$ 15,377</b>

<i>\$ in thousands</i>	<b>As at</b>	
	<b>March 31, 2019</b>	<b>December 31, 2018</b>
<b>Financial liabilities</b>		
Fair value through profit or loss		
Convertible debenture - embedded derivatives	\$ 266	\$ 265
Other financial liabilities		
Trade and other payables	96,810	99,576
Provision for commercial arbitration	10,642	12,508
Interest-bearing borrowings	2,921	4,138
Lease payables	1,065	113
Convertible debenture - debt host and interest payable	145,333	139,636
<b>Total financial liabilities</b>	<b>\$ 257,037</b>	<b>\$ 256,236</b>

## 6. REGULATORY ISSUES AND CONTINGENCIES

### ***Class Action Lawsuit***

In January 2014, Siskinds LLP, a Canadian law firm, filed a class action (the "Class Action") against the Company, certain of its former senior officers and directors, and its former auditors, Deloitte LLP, in the Ontario Court in relation to the Company's restatement of certain financial statements previously disclosed in the Company's public filings (the "Restatement").

To commence and proceed with the Class Action, the plaintiff was required to bring a preliminary leave motion and to certify the Class Action as a class proceeding (the "Leave Motion"). The Ontario Court rendered its decision on the Leave Motion on November 5, 2015 (the "November 5, 2015 Ontario Court Decision") and dismissed the plaintiff's Leave Motion as against each of the former senior officers and directors of the Company named in the Class Action on the basis that the "large volume of compelling evidence" proved the defense of reasonable investigation on the balance of probabilities and provided the basis for dismissing the Leave Motion as against them.

However, the Ontario Court allowed the Class Action to proceed under Part XXIII.1 of the Ontario Securities Act, permitting the plaintiff to commence and proceed with an action against the Company in respect of alleged misrepresentations affecting trades in the secondary market for the

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

Company's securities arising from the Restatement. The Company appealed this portion of the decision of the Ontario Court (the "Corporation Appeal").

The plaintiff appealed that part of the November 5, 2015 Ontario Court Decision dismissing the action against former officers and directors of the Company (the "Individual's Appeal"). The Individual's Appeal was brought as of right to the Ontario Court of Appeal.

On September 18, 2017, the Ontario Court of Appeal dismissed the Corporation Appeal of the original Ontario lower court decision to permit the plaintiff to commence and proceed with the Class Action. Concurrently, the Ontario Court of Appeal allowed the Individual's Appeal of the original Ontario lower court decision to dismiss the plaintiff's leave motion against certain of the Company's former officers and directors and made an order granting leave for the plaintiff to proceed against such former officers and directors of the Company in relation to the Restatement. As a result, the plaintiff is now permitted to proceed with the Class Action against both the Company and the former officers and directors.

The Company filed an application for leave to appeal to the Supreme Court of Canada in November 2017. The leave to appeal to the Supreme Court of Canada was dismissed in June 2018.

Counsel for the parties has appeared in a case conference before the motions judge. A procedure to fix the process and timing leading up to the trial of the action has been settled in broad terms including the favourable prospect of an early trial based to a large extent on the existing record. The details of the final process are being negotiated between counsel.

The Company firmly believes that it has a strong defense on the merits and will continue to vigorously defend itself against the Class Action through independent Canadian litigation counsel retained by the Company for this purpose. Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Class Action or determine the amount of potential losses, if any. However, the Company has judged a provision for this matter as at March 31, 2019 was not required.

### ***Toll Wash Plant Agreement with Ejin Jinda***

In 2011, the Company entered into an agreement with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd. to toll-wash coal from the Ovoot Tolgoi Mine. The agreement had a duration of five years from commencement of the contract and provided for an annual wet washing capacity of approximately 3.5 million tonnes of input coal.

Under the original agreement with Ejin Jinda, which required the commercial operation of the wet washing facility to commence on October 1, 2011, the additional fees payable by the Company under the wet washing contract would have been \$18.5 million. At each reporting date, the Company assesses the agreement with Ejin Jinda and has determined it is not probable that this \$18.5 million will be required to be paid. Accordingly, the Company has determined a provision for this matter at December 31, 2018 is not required.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

### ***Special Needs Territory in Umnugobi***

On February 13, 2015, the entire Soumber mining license and a portion of SGS' exploration license 9443X (9443X was converted to mining license MV-020436 in January 2016) (the "License Areas") were included into a special protected area (to be further referred as Special Needs Territory, the "SNT") newly set up by the Umnugobi Aimag's Civil Representatives Khural (the "CRKh") to establish a strict regime on the protection of natural environment and prohibit mining activities in the territory of the SNT.

On July 8, 2015, SGS and the Chairman of the CRKh, in his capacity as the respondent's representative, reached an agreement (the "Amicable Resolution Agreement") to exclude the License Areas from the territory of the SNT in full, subject to confirmation of the Amicable Resolution Agreement by the session of the CRKh. The parties formally submitted the Amicable Resolution Agreement to the appointed judge of the Administrative Court for her approval and requested a dismissal of the case in accordance with the Law of Mongolia on Administrative Court Procedure. On July 10, 2015, the judge issued her order approving the Amicable Resolution Agreement and dismissing the case, while reaffirming the obligation of CRKh to take necessary actions at its next session to exclude the License Areas from the SNT and register the new map of the SNT with the relevant authorities. Mining activities at the Soumber property cannot proceed until the License Areas are removed from the SNT.

On June 29, 2016, the Mongolian Parliament and CRKh election was held. As a result, the Company was aware that additional action may be taken in respect of the SNT; however, the Company has not yet received any indication on the timing of the next session of the CRKh.

### ***Mongolian royalties***

During 2017, the Company was ordered by the Mongolian tax authority to apply the "reference price" determined by the Government of Mongolia, as opposed to calculated sales price that is derived based on the actual contract price, in calculating the royalties payable to the Government of Mongolia. Although no official letter has been received by the Company in respect of this matter as of the date hereof, there can be no assurance that the Government of Mongolia will not disagree with the methodology employed by the Company in determining the calculated sales price and deem such price "non-market" under Mongolian tax law. Management believes that its interpretation of the relevant legislation is appropriate and the Company's positions related to the royalty will be sustained.

### ***Restrictions on Importing F-Grade Coal into China***

As a result of import restrictions established by Chinese authorities at the Ceke border, the Company has been barred from transporting its F-grade coal products into China for sale since December 15, 2018. The Company, together with other Mongolian coal companies, have been in discussions with Chinese authorities regarding a potential amendment or withdrawal of these import restrictions to allow for the importation of F-grade coal into China; however, there can be no assurance that a favorable outcome will be reached.

## **7. OUTSTANDING SHARE DATA**

The Company is authorized to issue an unlimited number of Common Shares without par value and an unlimited number of preferred shares without par value. As at May 14, 2019, approximately 272.7 million Common Shares were issued and outstanding. There are also incentive share options outstanding to acquire approximately 4.7 million unissued Common Shares with exercise prices ranging from CAD\$0.13 to CAD\$0.92. There are no preferred shares outstanding.

As at May 14, 2019, to the best of the Company's knowledge:

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

- CIC holds a total of approximately 64.8 million Common Shares representing approximately 23.8% of the issued and outstanding Common Shares;
- Novel Sunrise holds a total of approximately 46.4 million Common Shares representing approximately 17.0% of the issued and outstanding Common Shares; and
- Voyage Wisdom Limited holds a total of approximately 25.8 million Common Shares representing approximately 9.5% of the issued and outstanding Common Shares.

### **8. DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING ("ICFR")**

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management is responsible for the design of the Company's internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

The Company's internal controls over financial reporting include policies and procedures that pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions and disposition of assets, and which are designed with the objective of providing reasonable assurance that: (i) transactions are recorded as necessary to permit preparation of the financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with authorization of management and directors of the Company; and (ii) unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements is prevented or detected in a timely manner.

As discussed in Section 1 of the Company's management's discussion and analysis for the year ended December 31, 2018 (a copy of which is available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com)) under the heading entitled "Overview – Significant Events and Highlights – Restatement of Prior Year Financial Information" and elsewhere in this MD&A, the Company restated certain items in its statement of financial position as at December 31, 2017 and January 1, 2017 and statement of comprehensive income for the year ended December 31, 2017.

Management, including the Chief Executive Officer and Chief Financial Officer of the Company, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Management assessed the effectiveness of internal controls over financial reporting using the Internal Control – Updated Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. As of March 31, 2019, the Chief Executive Officer and Chief Financial Officer of the Company have each concluded that the Company's disclosure controls and procedures, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings ("NI 52-109"), were not effective due to the identification of certain material weaknesses as outlined below. Pursuant to NI 52-109, a "material weakness" is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial report will not be prevented or detected on a timely manner.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

Management identified the following material weaknesses relating to the design and effectiveness of the internal controls over financial reporting as at December 31, 2018:

- a) inadequate "know your customer" procedures in relation to the intake of new customers and insufficient due diligence undertaken prior to granting credit to customers, which increased the Company's exposure to credit risk;
- b) inadequate controls relating to the payment authorization and contract approval processes, which increased the risk of the Company entering into unauthorized or improper transactions;
- c) insufficient segregation of duties which increased the risk of bad actors colluding to act in ways which are detrimental to the Company;
- d) insufficient control of performing reconciliations of balances with customers or suppliers on a regular basis with documentation retained; and
- e) lack of a centralized information technology function which increased the risk of non-compliance with Company established documentation retention requirements.

A summary of the Remedial Actions and Preventative Measures which were adopted and approved by the Board to address the aforementioned material weaknesses is contained in Section 1 of this MD&A under the heading entitled "Overview – Significant Events and Highlights – Remedial Actions and Preventative Measures". Management is committed to remediating the issues which caused the Trading Suspension in a timely manner and will begin implementing the Remedial Actions and Preventative Measures as soon as practicable. Other than the Remedial Actions and Preventative Measures, there have been no changes in the Company's internal control over financial reporting during the three-month period ended March 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Once the Remedial Actions and Preventative Measures have been implemented, the Company will make a further announcement as to the results of the implementation of the Remedial Actions and Preventative Measures and the steps that the Company intends to take to apply for trading resumption on the HKEX and the TSX.

The Company has already taken proactive steps to address some of the issues raised by the Independent Investigation, including but not limited to: ceasing business activities with companies allegedly controlled by the Company's former management, taking steps to defend claims by third parties attempting to link the Company to the aforementioned companies, and considering whether legal recourse, such as collection actions, can be taken in respect of certain matters. See Section 1 of this MD&A under the heading entitled "Overview – Significant Events and Highlights – Remedial Actions and Preventative Measures".

Because of their inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements due to error or fraud. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by individual acts, by collusion of two or more individuals or by unauthorized override of controls. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

## 9. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS requires the Company to establish accounting policies and to make estimates and judgments that affect both the amount and timing of the recording of assets, liabilities, revenues and expenses.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

A detailed summary of all of the Company's significant accounting policies is included in Note 3 to the Company's consolidated financial statements for the year ended December 31, 2018.

The following new IASB standard was adopted by the Company on January 1, 2019.

IFRS 16	Leases <sup>(i)</sup>
(i)	Effective for annual periods beginning on or after January 1, 2019

The Company has adopted IFRS 16 retrospectively from January 1, 2019, but has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognized in the opening balance sheet on January 1, 2019. A detailed summary of the adjustments recognized under IFRS 16 is included in Note 2.3 to the Company's condensed consolidated interim financial statements for the three months ended March 31, 2019.

There have been no other new IFRSs or IFRIC interpretations that is not yet effective that would be expected to have a material impact on the Company, except those disclosed in the Company's annual consolidated financial statements for the year ended December 31, 2018.

## 10. RISK FACTORS

There are certain risks involved in and related to the Company's operations, some of which are beyond its control. Material risks and uncertainties affecting the Company, their potential impact on the Company's operations and the Company's principal risk management strategies are, except as updated by this MD&A, substantially unchanged from those disclosed in the Company's most recently filed Annual Information Form for the year ended December 31, 2018, which is available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

## 11. OUTLOOK

The Company believes that coal will continue to be the primary energy source which China will rely on in the foreseeable future, as coal has supported more than half of China's total energy consumption in recent years. However, growth in the demand for coal in China is expected to decline gradually in the long run for the following reasons: (i) increased adoption and utilization of clean energy; (ii) the implementation of stricter safety and environmental rules and regulations; and (iii) total energy consumption growth rates are expected to decrease over time.

The Company believes that the future trend of the coal industry in China will involve coal companies placing an increased emphasis on improving the quality of their coal products through enhanced screening and washing procedures and mine management.

Looking forward to 2019, the Company remains cautiously optimistic regarding the Chinese coal market. The expected benefit from the reduced supply of low quality coal and increased railway transportation capacity in China are anticipated to be offset by the uncertain Chinese macroeconomic environment.

The Company's objectives for 2019 and the medium term are as follows:

- **Enhance product mix** – The Company will focus on improving the product mix and increase production of higher quality coal by: (i) washing lower quality coal in the Company's coal wash plant; and (ii) improving mining operations and employing better mining technique and equipment.

# SouthGobi Resources Ltd.

## Management's Discussion and Analysis

---

- **Expand customer base** – The Company will endeavor to increase sales volume, expand its sales network, strengthen its sales and logistics capabilities and diversify its customer base.
- **Increase production and optimize cost structure** – The Company will aim to increase coal production volume to take advantage of economies of scale. The Company will also focus on reducing its production cost and optimizing its cost structure through innovation, training and productivity enhancement.
- **Progress growth options** – Subject to available financial resources, the Company plans to further the development of the Soumber Deposit in the medium term, while complying with all government requirements in relation to its licenses and agreements.
- **Operate in a socially responsible manner** – The Company will continue to maintain the highest standards in health, safety and environmental performance in a corporate socially responsible manner.

Going forward, the Company will continue to focus on creating shareholders value by leveraging its key competitive strengths, including:

- **Strategic location** – The Ovoot Tolgoi Mine is located approximately 40km from China, which represents the Company's main coal market. The Company has an infrastructure advantage, being approximately 50km from a major Chinese coal distribution terminal with rail connections to key coal markets in China.
- **A large resources and reserves base** – The Ovoot Tolgoi Deposit has mineral reserves of 114.1 million tonnes, while the aggregate coal resources include measured and indicated mineral resources of 194.6 million tonnes and inferred resources of 32.1 million tonnes.
- **Several growth options** – The Company has several growth options including the Soumber Deposit and Zag Suuj Deposit, located approximately 20km east and approximately 150km east of the Ovoot Tolgoi Mine, respectively.
- **Bridge between Mongolia and China** – The Company is well positioned to capture the resulting business opportunities between China and Mongolia under the “One Belt, One Road” program. The Company will seek potential strategic support from its two largest shareholders (i.e., CIC and Cinda), which are both state-owned-enterprises in China, and its strong operational record for the past twelve years in Mongolia, being one of the largest enterprises and taxpayers in Mongolia.

May 14, 2019